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The Color of Money

Bad Credit, Wealth, and Race

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This article examines the myth of bad credit in the Black community. Historically, Blacks have had higher savings rates and lower use of credit than Whites. Discrimination in lending led to an aversion to credit. Later, Blacks believed their credit to be bad, even among many better qualified Black loan applicants. The authors find that there is no statistically significant difference in the average level of "bad credit" among Blacks and Whites who have been turned down for loans or who have not applied for loans, as seen in national data sets measuring wealth and expenditures. Contrary to conventional wisdom, no statistically significant difference exists in bad credit rates between Black and White households at the lowest and highest wealth levels. The authors contend that the observed differences in the bad credit rates between Blacks and Whites in the middle wealth range are attributable to different treatment of Blacks and Whites in credit markets.

I wear tight clothing and high heel shoes
That doesn't make me a prostitute
I like rap music, wear hip-hop clothes
That doesn't mean that I'm sellin' dope

. . .

So I'm a sista
Buy things with cash
That really doesn't mean that all my credit's bad

. . .

(En Vogue—"Free Your Mind")[1]

Blacks have lower incomes, lower home ownership rates, less access to credit, and higher loan denial rates than do Whites. A common misconception within the social science community is that the cause of these deficits is poor credit among African Americans.

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The popular lyrics cited above, by the Black singing group En Vogue, succinctly convey a significant perspective within the Black community on this explanation for Black money woes. Whereas many Blacks indeed do not use conventional credit cards and may pay for their goods and services in cash, that behavior—like wearing tight skirts and high-heeled shoes—does not always mean what observers think it means. Blacks almost uniformly reject the contention that their poor economic outcomes are due solely to their credit deficiencies. They deny that they have brought on themselves poor credit records. At the same time, they privately admit that the perception of Blacks as poor credit risks is widely held both in the Black community and in the community at large.

This article examines the myth of bad credit in the Black community. It seeks to put into context recent highly publicized attacks on evidence of lending discrimination and vocal objections to efforts by lenders and others to improve home ownership and access to mortgage credit through credit repair and credit education initiatives. We will show in this article that historically, Blacks have had higher savings rates than Whites—a positive indicator when assessing credit risk—but nonetheless have been subjected to discrimination in lending. This legacy of discrimination has contributed to a long-term aversion to credit among many better qualified potential loan applicants. Neither the high savings rate nor their lower use of credit has shielded even good Black credit risks from the statistical illusion that all Blacks are bad risks. The result, we demonstrate, is that many high-quality potential Black borrowers incorrectly believe that their credit is worse than it is. We also demonstrate that there is really no statistically significant difference in the average level of "bad credit" among Blacks and Whites who have been turned down for loans or who have not applied for loans, as seen in national data sets measuring wealth and expenditures. We find, contrary to conventional wisdom, no statistically significant difference in bad credit rates between Black and White households at the lowest and highest wealth levels. We contend that the observed differences in the bad credit rates between Blacks and Whites in the middle wealth range are attributable to different treatment of Blacks and Whites in credit markets.

In short, we expose herein the myth that Blacks uniformly have worse credit than Whites. In doing so, we nonetheless find that there are some plausible explanations for why some Blacks do indeed have worse credit than Whites. One such explanation is that Blacks expend more than Whites on rental housing, which results in lower assets and lower net worth, leading to poorer credit.

We contend that the legacy of poor access to credit and wealth accumulation—mostly in the form of explicit discriminatory lending barriers—has contributed to attitudes toward credit that adversely affect Black credit ratings. In a way then, we propose that past wealth inequality and the credit institutions supporting it contribute to bad credit in the present.

To reach this conclusion, we first review the contradictory evidence of discrimination in credit markets. We then turn to the legacy of bad credit in the African American community. We argue here that Blacks have been excluded from

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credit opportunities that would have helped to provide them with positive credit records. This perspective is central to establishing that it is the perception that Blacks have bad credit and not the reality of their bad credit that seems to drive current lending. To buttress this contention, we marshal evidence from the Survey of Consumer Expenditures, which shows that among those who were turned down for loans or who did not apply for loans because they believed they would be turned down, Black credit is no worse than White credit. Nevertheless, focus group results from a study conducted in Columbia, South Carolina, reveal that there is a general belief, even among Blacks, that Blacks have bad credit. We rely on the highly contentious findings from a recent survey commissioned by Freddie Mac showing that Blacks have worse credit than Whites to argue that these findings must be balanced against the evidence from the same study showing that Blacks with good credit consistently underestimate their good credit. This is firmly compatible with a form of statistical discrimination that is self-fulfilling: Lenders believe that Blacks have bad credit, so they are more likely to deny Blacks loans than Whites. Blacks with good credit, observing that Blacks are denied credit in disproportionate numbers, begin to believe that they, too, would be turned down for loans and assume that they, too, have bad credit. Blacks with bad credit apply for loans and, like whites with bad credit, are turned down. Unfortunately, the Blacks who are turned down for loans (and who have bad credit) label the entire population of potential borrowers as having bad credit. Whites with bad credit, who represent a relatively small portion of the White population, do not so label the entire White population. The resulting racial divide is maintained because Blacks with good credit continue to believe that they have bad credit, and Blacks with bad credit continue to signal to the market that all Blacks are like them.

In our concluding remarks, we reiterate our claim that bad credit serves as a false explanation for the wide racial gaps in loan outcomes. The implication, then, is that efforts to curb Blacks' bad credit, especially those efforts focusing on persons already heavily involved in the credit market, might have just the opposite impact than that intended. Although helping those suffering from poor planning and financial management can be justified on other grounds, one runs the risks of further demonizing Blacks as a group and foregoing profit-making opportunities to draw into the credit market good credit risks among African Americans who historically have been averse to borrowing.

BACKGROUND

In 1992, the Boston Federal Reserve published a pioneering study, "Mortgage Lending in Boston: Interpreting HMDA Data," that established the existence of racial discrimination in mortgage lending (Munnell, Browne, McEneaney & Tootell, 1992, 1996). Initially, the study received widespread media exposure supporting the view that the wide disparity in loan rejection

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rates was attributable to unequal treatment of equally qualified loan applicants. The Boston study, unlike any before it, controlled meticulously for virtually every conceivable alternative explanation for why Blacks (and Hispanics) might be more likely to be denied loans. The study focused explicitly on various measures of credit worthiness and likelihood of default. The conclusion was inescapable: Even after controlling for credit risk, Blacks and Hispanics were more likely to be denied loans than equally qualified Whites.

The study, however, caused considerable consternation among Boston-area lenders and underwriters, national banking regulators, and the Federal Reserve Board's research staff. Soon after the study was published, there was an avalanche of denunciations. These groups had hoped that the Federal Reserve study would "convincingly demonstrate that race was not a determining factor in loan decisions" (Goering & Wienk, 1996, p. 15). The study found, however, that "race was indeed a fairly powerful influence in lending decisions" (Goering & Wienk, 1996, p. 15), and it confirmed earlier data that

> revealed that the rejection rates for African Americans were twice as high as those for whites—rates comparable to those found over 20 years earlier (Listokin and Casey, 1980, p. 58) and virtually identical to the disparities found in 1994 HMDA data. (Goering & Wienk, 1996, p. 13)

This finding was the opposite of what the lending industry had been preaching.

A cottage industry of sorts evolved—much of it financed by the American Bankers Association and various lender and mortgage lending associations—that was designed to discredit the Boston Federal Reserve's findings.

Criticisms of the Boston Federal Reserve study abound. Most center on the question of whether the Boston Federal Reserve adequately controlled for all measures of credit risk. A recent illustration of such criticisms comes from work on student loans. Boyd (1997) contended that Blacks have a higher rate of default than Whites in the Stafford Loan Programs. He found that Blacks are more likely to be studying for degrees that yield lower incomes; they are less likely to graduate; and ultimately, they are less likely to be able to repay their student loans. The dominant cost of the high default rates on these loans is the higher risk that Blacks impose on lenders when they apply for future loans. In a nutshell, this view contends that Blacks are not discriminated against in the mortgage market. Instead, race of the loan applicant captures prior defaults. The problem then is risk, not race, in this view.

Another conventional explanation for why there is no discrimination against Blacks in the loan market, despite the showing of wide racial gaps in lending, is that Blacks are more likely to default on Federal Housing Administration (FHA) loans. This finding, stemming from work of Berkovec, Canner, Gabriel, and Hannan (1994), contends that if there were discrimination against Blacks, only the very best risks would be allowed access to loans. Thus, only the very best

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risks among Blacks would be observed in default, and thereby their default rates should be lower than average. Because their default rates are higher than average, so this reasoning goes, Blacks are not being discriminated against. The higher loan denial rate is justified because of the higher risk of default. Blacks, bankers contend, are simply worse risks.

Still, strong counterfindings support the original results of the Boston Federal Reserve. One careful and detailed replication of the Federal Reserve analysis found that "an African American is still more than twice as likely as a white to have his home mortgage loan application rejected" (Carr & Megbolugbe, 1993). Another more exhaustive evaluation concluded,

> Compared to their white counterparts, African American and Hispanic home seekers are shown far fewer houses and apartments (and indeed sometimes excluded from available housing altogether), given far less assistance in finding the house or apartment that best fits their needs and in finding a mortgage, and are steered to neighborhoods with minority concentrations or low house values. (Yinger, 1995, p. 5)

In other words, even in the face of skepticism about the Boston Federal Reserve's study, there are those who believe that discrimination plays a significant role in determining loan outcomes for Blacks. This, however, is neither the dominant belief among social scientists nor the prevailing view among economists. The conventional wisdom continues to be that Blacks have worse credit than Whites.

THE LEGACY OF BAD CREDIT

Blacks long have been denied credit because lenders believed they were untrustworthy. This denial was hardly based on some objective measure of their lower credit ratings, as, for instance, a numerical credit score. Rather, they were denied credit in an era when "a man's word was his bond" and the word of Blacks was not valued. As Martha L. Olney (1998) has demonstrated in her examination of the 1918-1919 Consumer Purchases Survey data, in the early 1900s, Blacks and Whites used different types of credit to make major life purchases. Besides paying in cash, many families used installment or merchant credit to purchase life necessities. Merchant credit involved an informal arrangement whereby a good—such as groceries—was purchased upon a promise to repay at a later date. There was no legal recourse to a merchant who was not repaid. The goods often were consumed first and the bill paid later. In this instance, a "man's word was his bond." Installment credit involved outlays "whereby a customer promises to make regular payments over time in exchange for goods received" (Olney, 1998, p. 409). This is a formal contract, often requiring a down payment of 15% to 25%, with repayment—usually with interest—to be made during a fixed period of 1 year or 18 months. The formal transfer of ownership of goods does not occur until the bill is paid. The property itself

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serves as collateral, with failure to repay resulting in repossession. At least in the earliest periods of repayment, before the good was depreciated, the lender could overcome the risk of default by recovering the purchased commodity.

It is obvious that merchant credit is a more favorable form of credit than installment credit. It is also obvious that a group's experiences with merchant credit may influence a merchant's views of the group as potential customers and borrowers.

For our purposes, the key finding of the Olney study concerns racial differences in use of installment and merchant credit.

- Black families used the installment plan much more often than did White families: Thirty-seven percent of Black families but only 21% of White families used the installment plan.
- Black families were less likely to use merchant credit. Twenty-two percent of Black families and 25% of White families used merchant credit (Olney, 1998, p. 410).

Further analysis of these data by Olney (1998) showed that "lower income black families saved more and saved more often than did lower income white families" and "poor black families apparently compensated for their lower use of merchant credit with a strategy of simultaneously using the installment plan and saving money" (p. 427). These data did not show that Blacks had worse credit than Whites but rather that merchants *felt* that Black families' credit worthiness was less than that of White families. Thus, poor Blacks had relatively high savings rates and often *no credit at all*. They paid for all of their goods with cash or with large down payments and installment plans.

So, why did Blacks have a lower-than-average use of merchant credit? Olney (1998) performed a Blinder-Oaxaca residual difference analysis and concluded that most of the racial gap in access to merchant credit cannot be attributed to racial differences in customer characteristics. Instead, there was discrimination against Blacks. Equally qualified Blacks and Whites were treated differently when it came to receiving merchant credit. The Black man's word was not accepted in the same way as the White man's word.

The devastating consequence of this historical legacy of discrimination in credit is that Blacks have been overrepresented among those using the worst type of credit available: installment credit on durable goods. Along with heavy reliance on predatory lenders and loan sharks, the concentration of Blacks in the bottom of the credit market has contributed to a tainted perception of Blacks' credit risk. This is true, even though Blacks have had higher-than-average savings rates in the decades when they were denied credit from merchants. Thus, instead of convincing lenders that they are good risks, as evidenced by their ability to save their money and purchase goods outright, the reliance on installment credit caused them to convey to lenders that they were bad risks.

The view that Blacks have a bad-credit problem stems from this legacy of lack of access to preferred forms of credit. Before the wide use of credit cards

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TABLE 1: Freddie Mac Press Release on Credit Ratings by Race

Credit Record	*White*	*Black*	*Hispanic*	*Combined*
Bad	27%	48%	34%	30%
Indeterminate	12%	16%	15%	13%
Good	61%	36%	51%	57%

SOURCE: Freddie Mac (1999).

and home mortgages, Blacks did not have equal access to conventional credit. Without access to the same sort of credit available to Whites, Blacks needed to hoard their money to accumulate enough for purchases. This type of savings behavior, often seen among Asian and West Indian immigrant groups, is consistent with good credit, not bad credit. Yet, the perception that Blacks have bad credit has permeated American society.

A recent Freddie Mac (1999) survey of Americans, the Freddie Mac Consumer Credit Survey (CCS), showed that "having a poor credit record is a relatively common problem in today's society," and "credit problems persist across income groups." Still, the study concludes that "minority borrowers are more likely than white borrowers to experience credit problems." Forty-eight percent of African Americans were deemed to have bad credit, whereas only 27% of Whites were. Table 1, produced from the Freddie Mac press release, shows these results.

According to Freddie Mac's press release, Blacks and Hispanics are more likely to have bad credit, they are less likely to have good credit, and they are more likely to have indeterminate credit than are Whites. Whereas the majority of Whites and Hispanics have good credit, the release contends, the majority of Blacks are likely to have indeterminate or bad credit.

This conclusion caused outrage among members of Congress and journalists. Two quotations from the *Washington Post* reflect this response:

> A Freddie Mac study concluding that far more black people have bad credit than white people, even when both have the same incomes, has come under attack in Congress, and some experts have questioned whether it oversimplifies a complex issue. (Cohn, 1999, p. B1)
>
> I strongly reject Freddie Mac's assertion that the reason African Americans own fewer homes than whites is that they have "bad credit." (Waters, 1999, p. A21)

The perception that Blacks have bad credit, however, is even more pervasive. Missed in the brouhaha over the claim that Blacks have worse credit than Whites was the more telling finding that a large share of good-credit Blacks underestimate their credit rating. The Freddie Mac (1999) press release states that "only 49% of African-American respondents with 'good' credit records self-assess their own records as either 'good' or 'very good,' compared to 64% of Hispanics and 72% of White respondents." In other words, the vast majority of Whites,

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TABLE 2: Distribution of Expenditures, 1995

	Percentage		*Ratio of Black to*
	All Consumer Units	*Black*	*All Consumer Units*
Food	13.96	14.51	1.039497
Alcoholic beverages	0.86	0.66	0.770234
Housing	32.42	34.29	1.057551
Apparel and services	5.28	7.43	1.407595
Transportation	18.64	19.01	1.019888
Health care	5.37	4.46	0.830904
Entertainment	4.99	3.89	0.779793
Personal-care products and services	1.25	1.56	1.247669
Reading	0.51	0.32	0.625283
Education	1.46	1.08	0.738621
Tobacco products and smoking supplies	0.83	0.74	0.889125
Miscellaneous	2.37	1.92	0.808982
Cash contributions	2.87	2.37	0.828591
Personal insurance and pensions	9.19	7.76	0.843674

SOURCE: Authors' computations from Table No. 733, Average Annual Expenditures of All Consumer Units by Race, Hispanic Origin, and Age of Householder, 1995 (U.S. Census Bureau, 1998, p. 464)

nearly three quarters of them, with good credit correctly rated their credit. The majority of Blacks with good credit did not correctly assess their credit. Thus, although many Blacks have bad credit—and it should be noted that according to the Freddie Mac press release, this is not the majority of Blacks—many have good credit but do not believe that they have good credit.

DOES LOW WEALTH OR INCOME CAUSE BAD CREDIT?

One explanation given for why Blacks are not as credit worthy as Whites, and thus are less likely to receive approval for mortgages, is that they have low incomes and low net worth. In 1995, the median income (in current dollars) for all households was $34,076, whereas it was $22,393 for Black households. In addition, the average expenditures per household for all consumer units were $32,277, whereas they were $23,270 for Black households. In other words, Blacks have lower incomes than Whites, but they spend a larger share of their incomes than Whites do. This is a prescription of poor credit.

But how do Blacks spend their money? Table 2 shows the distribution of expenditures in 1995 by category, derived from statistics on consumer expenditures compiled by the U.S. Bureau of Labor Statistics (U.S. Census Bureau, 1998).

A larger share of Black expenditures is devoted to food, housing, apparel, transportation, and personal-care products and services than is the case for all consumer units. Particularly disparate is the gap in expenditures for rental

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housing. Housing accounts for 34.29% of all Black expenditures, by far the largest component of Black expenditures. It accounts for 32.42% of all consumer units' expenditures, making this category of expenditure the largest component for all consumer units as well.

The breakdowns in actual housing expenses are provided in Table 3. The share of all expenditures devoted to rental expenses is 1.85 times higher for Blacks than for all consumer units; the share of housing expenditures devoted to rental expenses is 1.75 times higher for Blacks than for all consumer units. Black households also devote larger shares of their expenditures to utilities than other consumer units.

In short, the low incomes of Blacks are devoted to significant expenditures on rental housing that rob these households of the opportunity to save and thus to obtain down payments needed to become homeowners. It is not frivolous spending on liquor or entertainment that robs African Americans of the means to establish good credit. Rather, it is the heavy dependence on rental housing. And although it is true that Blacks spend more heavily on transportation, personal care, and apparel than do Whites, what is most important to underscore is the fact that they spend most of their money on housing.

Blacks make up about 8.3% of all homeowners in America as shown in Table 4, but they comprise only 6.4% of those who hold conventional mortgages and are overrepresented among those who hold FHA, Veterans Administration (VA), and Farmers Home Administration mortgages. Indeed, among the 5 million FHA mortgages held in 1997, African Americans comprise 15.77% of the total.

In other words, Blacks rely heavily on government programs to support their dreams of becoming homeowners. They are substantially underrepresented among those holding conventional mortgages. This continues the legacy of exclusion begun in the postemancipation era. Black bad credit, then, is an artifact of the lack of access to conventional credit.

EVIDENCE FROM SOUTH CAROLINA

In an effort to distinguish fact from fiction, researchers at Benedict College, a historically Black college in Columbia, South Carolina, studied the attitudes of Blacks and Whites concerning credit. A total of nine focus groups were held to examine different races' attitudes toward credit. Four African American focus groups were convened, two with good credit and two with bad credit. Three similarly formed groups of Whites were held, two with good credit and one with bad credit. Two other specially formed groups were held, one mixed race group of armed servicemen and an African American student group. Each group had between 10 and 15 participants.

In forming these groups, good credit was defined as not having been 30 days late on a payment more than once in the past 2 years and having no other derogatory credit marks, such as liens or bankruptcies. Bad credit was defined as

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TABLE 3: **Annual Consumer Expenditures on Housing, 1995**

	All Consumer Units			*Blacks*			*Ratio of Black to All Consumer Units*	
	Dollars	*Percentage of Total Expenditures*	*Percentage of Housing Expenditures*	*Dollars*	*Percentage of Total Expenditures*	*Percentage of Housing Expenditures*	*Share of Total Expenditures*	*Share of Housing Expenditures*
Total expenditures	$32,277	100.00	100.00	$23,750	100.00	100.00	—	—
Housing total	$10,465			$8,144				
Owned dwellings	$3,754	11.63	35.87	$1,922	8.09	23.60	0.70	0.66
Rental dwellings	$1,786	5.53	17.07	$2,433	10.24	29.87	1.85	1.75
Other lodgings	$392	1.21	3.75	$147	0.62	1.81	0.51	0.48
Utilities, fuels, and public services	$2,193	6.79	20.96	$2,206	9.29	27.09	1.37	1.29
Household operations	$508	1.57	4.85	$318	1.34	3.90	0.85	0.80
Housekeeping supplies	$430	1.33	4.11	$255	1.07	3.13	0.81	0.76
Household furnishings and equipment	$1,403	4.35	13.41	$862	3.63	10.58	0.83	0.79

SOURCE: Authors' computations from Table No. 733, Average Annual Expenditures of All Consumer Units by Race, Hispanic Origin, and Age of Householder, 1995 (U.S. Census Bureau, 1998, p. 464).

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TABLE 4: Homeowners and Type of Financing of Housing, 1997

	Total Occupied Units (in thousands)	*Black Occupied Units (in thousands)*	*Black Percentage*
Total home owners	65,487	5,457	8.33
Owned free and clear	25,453	2,047	8.04
With regular mortgage	35,855	3,104	8.66
Type of mortgage			
Conventional	25,579	1,626	6.36
FHA	5,065	799	15.77
VA	1,936	263	13.58
Farmers Home Administration	364	57	15.66

SOURCE: U.S. Census Bureau, 1997, p.144.
NOTE: FHA = Federal Housing Administration; VA = Veterans Administration.

having been either 90 days late on a payment in the past 2 years; 30 days late on a payment more than once in the past 2 years; or having a record of delinquent liens, adverse entries on public records, or bankruptcy. Potential participants were randomly selected from a database constructed and used by a marketing research firm in Columbia, South Carolina. Participants had previously agreed to take part in the firm's research projects.

Each group was asked questions about financial planning, attitudes toward credit, whether lenders understand people with credit problems, and how they learned about credit. Each group was audio- and videotaped.

A key finding of the focus groups was that the legacy of barred opportunities to credit has created an environment of poor credit habits. A parallel finding is that Blacks' understanding of financial instruments and the operation of the credit market differs from that of Whites.

One African American participant noted that she wished that she had followed the example of her grandmother, who used no credit, paying for everything in cash. Another stated,

> I haven't used a credit card probably in over 12 years, and I think one reason is the debit card. If I don't have it, I don't need it, and I don't want it. I wait and save and get it another way, but I'm not going to pay that high interest rate. (African American, good credit)

In virtually each group interviewed, there was at least one person who did not have a credit card. There appeared to be a fear of using credit and falling into a trap of bad credit.

"I've used them. You know, I've abused them. I've learned. I don't want to do that anymore. I can do without it" (African American, good credit). Even in the good-credit group, some African Americans paid only the minimum amount due on their credit cards. Some noted that whether they paid their credit bills "depended on the month and other bills."

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There appeared to be a lack of knowledge among Black respondents about credit options—such as paying more than the minimum amount due on a credit card. There also appeared to be vast differences in the types of credit on which Blacks and Whites relied. Although both have an aversion to paying interest on credit cards, they differ in how they obtain credit for major life purchases.

Whites discussed borrowing money from finance companies, retirement plans, through home equity lines of credit, or from the cash value of life insurance policies. Blacks, in contrast, depended primarily on store credit cards, banks, and credit unions to meet their credit needs.

Significant was the heavy reliance among Blacks on store credit. For years, the primary place Blacks could obtain credit was from stores. Major department stores such as Sears and JC Penney extended credit to African Americans. For some, this was the only means by which to purchase major appliances such as washers and dryers, furniture, and other essentials for everyday living. The price of credit was very high. Yet, families built an allegiance to Sears for major purchases. Today, many African Americans families still rely on Sears for major purchases, even though the interest rate on a Sears credit card is around 21%. On the other hand, Whites had other options for credit. Their discussion of credit did not focus on department stores such as Sears, although both Whites and Blacks mentioned Sears.

Respondents related the ease with which Sears granted store credit cards, but they also noted the speed with which Sears cut off credit in response to late payments. Thus, the Sears credit card, and store credit cards generally, acted as a double-edged sword. When other lenders restricted credit to Blacks, durable-goods stores advanced credit to them, albeit at high interest rates. The downside to obtaining easy credit from department stores, however, was the harsh reality of obtaining negative credit ratings because of late payments or delinquencies. With bad credit—such as that generated from Sears purchases—the only source of credit thereby becomes existing store credit cards.

There were other differences in the understanding of financial instruments. When discussing financial planning, Whites discussed financial instruments such as 401k plans, pensions, and the stock market. Some Whites talked extensively about stock options provided by their companies and placing income in stocks instead of in a regular saving account. Even poor-credit Whites discussed the advantages of borrowing money for investments and the tax implications of different financial options. In not one of the African American focus groups was there any discussion of the stock market or related investment outlets. There was little mention of pensions or other savings vehicles.

The qualitative evidence from the focus groups in South Carolina supports the contention that Blacks and Whites have different experiences dealing with financial-planning institutions. Blacks are heavily concentrated in those areas of the credit market with the highest costs and the fewest opportunities for establishing unblemished records. Thus, just as at the turn of the century, when Blacks relied heavily on poorly regarded installment credit, we find that at the

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TABLE 5: Survey of Consumer Finances, 1995, Descriptive Statistics

	Blacks (n = *1,899*)	*Whites* (n = *17,809*)
Net worth	$43,973	$251,590
Bad credit (%)	20.5	9.9
Loan denial (%)	25.3	16.4
Loan denial given application (%)	44.8	25.1
Nonapplication (%)	25.3	12.8

SOURCE: Authors' computation from Federal Reserve Board's (1995) Survey of Consumer Finances data tape.

end of the century, Blacks still rely heavily on high-interest store credit that most quickly promises to damage credit ratings. The implication is that the legacy of unequal access to wealth contributes to bad credit.

EVIDENCE FROM THE SURVEY OF CONSUMER FINANCES

We also examined the Federal Reserve Board's (1995) Survey of Consumer Finances (SCF). This survey has been conducted every 3 years since 1983. Wealthy households are overrepresented in the sample, which was obtained from a special file of tax records. There is very detailed information on assets and liabilities. This nationally representative data set is the very best available on wealth and net worth.

From the survey, we were able to compute measures of bad credit, loan denials, and loan nonapplication rates. We were also able to compute these measures by wealth quintiles. The bad-credit category comprises those who (a) were turned down for a loan in the past 5 years because of adverse information in a credit report, poor credit record, foreclosure, or bad credit; or (b) did not apply for a loan because they believed they would be turned down because of adverse information in a credit report.

The loan-denial category comprises those who were ever turned down—in the past 5 years—for a loan from a bank, a credit union, another lender, or from a revolving credit card, bank card, other credit card, or store credit card.

The loan-nonapplication category comprises those who ever did not apply for a loan in the past 5 years because they believed they would be turned down, rejected because of bad credit, rejected because of race.

Table 5, compiled from data from the 1995 SCF Descriptive Statistics, shows that Whites have a net worth 5 times greater than that of Blacks, that Blacks are twice as likely to have bad credit, and that Blacks are more likely to be denied loans compared with Whites. Blacks were twice as likely as Whites not to apply for a loan because they believed that they would be rejected.

These statistics would suggest that high loan denial rates faced by Blacks might be due to higher bad credit rates and/or lower net worth. Yet, we find

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TABLE 6: Loan Denial Rates and Loan Nonapplication Rates by Wealth Quintiles

	Loan Denial Rate			*Nonapplicant Rate*		
	Black	*White*	*Black-to-White Ratio*	*Black*	*White*	*Black-to-White Ratio*
Top fifth	0.192	0.058	3.310345	0.107	0.029	3.689655
Next fifth	0.251	0.101	2.485149	0.156	0.066	2.363636
Middle fifth	0.303	0.182	1.664835	0.327	0.112	2.919643
Next fifth	0.262	0.253	1.035573	0.384	0.207	1.855072
Bottom fifth	0.229	0.296	0.773649	0.445	0.306	1.454248

SOURCE: Authors' computations from the Federal Reserve Board's (1995) Survey of Consumer Finances data tape.

contradictory evidence when we categorize the data into wealth quintiles (Table 6). Applicants in the top 5th quintile have greater wealth than 80% of all other Americans. If the low wealth of African Americans were the explanation for the poor performance in credit markets, then one would expect that loan denial and nonapplication rates would be higher at the lowest wealth quintiles. This is not what is shown in Table 6. Instead, we discover that the disparity is larger at the top of the wealth distribution than at the bottom. This is hardly support for the contention that Blacks' poor loan outcomes stem from their lesser wealth. Blacks in the top 5th quintile were three times more likely to be denied a loan than Whites in the top 5th quintile. In addition, Blacks in the top 5th quintile were 3.7 times more likely not to apply for a loan because of a fear of being denied than were Whites. Blacks in the lowest quintile of wealth have *lower loan denial rates than Whites*. Moreover, Blacks' loan nonapplication rates are lower relative to Whites at the bottom than at the top of the wealth distribution.

Of course, one reason why loan denial rates differ so substantially at the top of wealth distribution is that wealthy Blacks have worse credit than wealthy Whites. (Note that the measurement of the wealth quintiles is race neutral, so that Blacks and Whites in the quintiles have the same wealth.) Table 7 disputes this assertion. There is no difference between Blacks and Whites at the top of the distribution in the measure of bad credit. Nor is there any difference in bad credit at the bottom of the distribution. To be sure, there are differences in the middle, but here lies the puzzle. In the middle of the wealth distribution, Black bad credit is 2.3 (.245/.105) times that of Whites. Yet, in the middle quintiles, the Black loan denial rate is only 1.6 times that of Whites. Are Blacks at the top being penalized for perceptions based on the behaviors of Blacks at the middle?

Among Whites, there is an inverse relationship between wealth and bad credit, as one might expect. Whites in the highest quintiles of wealth have the lowest measured bad credit; Whites with the lowest wealth have the highest measured bad credit. In comparison, the highest bad credit among Blacks is registered among those in the middle range wealth quintile. The least wealthy Blacks have lower bad credit rates than Blacks of midlevel wealth.

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TABLE 7: Ratio of Families With Bad Credit, by Race

Wealth Quintile	*Blacks*	*Whites*
Top fifth	.032	.031
Next fifth	.093	.048
Middle fifth	.245	.105
Next fifth	.273	.173
Bottom fifth	.187	.185

SOURCE: Authors' computations from the Federal Reserve Board's (1995) Survey of Consumer Finances data tape.

TABLE 8: Estimated Bad Credit for the Entire Sample Versus Conditional Sample (in percentages)

	Probability of Bad Credit	*Conditional Probability of Bad Credit*
Blacks	20.50	65.50
Whites	9.90	64.30
Others	16.00	54.30

SOURCE: Authors' computations from the Federal Reserve Board's (1995) Survey of Consumer Finances.

Again, this finding contradicts the notion that the problem of poor credit among Blacks is that they are poor. More telling is the test of whether bad-credit rates differ between Blacks and Whites. Although Table 7 seems to say that Blacks do indeed have worse credit than Whites, the truth is a bit more complicated. The bad-credit variable computed in that table is derived for all persons in the sample. Those who applied for loans and were not turned down are included in the calculations, although technically, our definition of bad credit relates to persons who did not apply for loans or who were turned down. When we restrict our sample to this conditional population (Table 8), we find that there are no statistically significant differences between the bad-credit rates of Blacks and Whites.

Given our contention that among Blacks, bad-credit risks are disproportionately drawn into the credit market, and noting the high fraction of Blacks who did not apply for loans at all, it is not surprising that the ratio of Black-to-White bad-credit probabilities is greater in the whole population than it is in the subset of the population from which we derived the bad-credit variable. Stated differently, because Blacks were more likely than Whites to be denied loans once they applied, they are more likely to appear in the larger population to have bad credit.

The failure to find racial differences in bad credit among those who have been denied loans or those who failed to apply for loans—coupled with Freddie Mac's (1999) finding that good-credit Blacks do not know that they have good credit—suggests that bad credit is oversold as an explanation for the poor loan

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performance of Blacks. Race continues to glare through these data, compelling the reader to examine alternative explanations for the persistently low levels of loan availability faced by African Americans.

CONCLUDING REMARKS

As the song goes, "*So I'm a sista, Buy things with cash, That really doesn't mean that all my credit's bad.*" Just as not all Blacks are gangsters or drug dealers, so too not all Blacks are deadbeats and poor-credit risks. We argue in this article that the rush to indict an entire African American community, even when a disproportionate number of persons in that community have bad credit, is rooted in a complex reality wherein Black credit attitudes and credit behaviors are influenced deeply by a legacy of lack of access to credit-enhancing financial institutions. African Americans ended the past century facing the same discriminatory lending barriers that were solidly in place at the beginning of the century. Faced with contentious objections to this characterization of their plight, some Blacks have internalized a negative imagine of Black credit worthiness to the point that even good Black credit risks believe that they have bad credit. Blacks who really do have bad credit overpopulate the lower reaches of the credit markets. This signals to lenders and the population in general that, indeed, Blacks are bad credit risks.

Because of this phantom explanation for Blacks' limited access to conventional loan markets, even well-meaning lenders continue to engage in what can be termed, correctly, *statistical discrimination*. This is opposed to blatant and bigoted discrimination reminiscent of the turn of the 20th century, when Blacks' word was simply not trusted. The result, nevertheless, is the same. Blacks have not been able to receive the same type of credit options, mortgage financing, and financial information as their White counterparts. They have accumulated less wealth than have Whites.

The urgent call from those lenders and mortgage market leaders to educate Blacks and provide them with new tools for improving their credit worthiness ironically comes at a time when new predatory lending practices have escalated to take advantage of the presumption that Blacks have bad credit. The well-meaning argument persists that the current status of Blacks is due to their own failings and their poor credit. If Blacks just developed better financial planning and spending restraints, then they would develop better credit records and achieve higher levels of wealth.

This article challenges the widely held belief of Black credit inferiority and contends that Blacks have been excluded from good credit opportunities and thus are concentrated at the bottom of the credit well. The effect of the legacy of poor credit options is that even Blacks with good credit risks believe that they have bad credit. This further forestalls better qualified Blacks from exploring the top segments of the credit market—such as those devoted to financing

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investments rather than consumption—and ensures that Blacks will carry the stigma of being a bad credit risk far into another generation.

NOTE

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